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SUPREME COURT, U.S.

No. [redacted] 114

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FILED
JUN 4 1954
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

GENERAL AMERICAN INVESTORS COMPANY, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

NORRIS DARRELL,
JOHN F. DOOLING, JR.,
Counsel for Petitioner,
48 Wall Street,
New York 5, N. Y.

SULLIVAN & CROMWELL,
48 Wall Street,
New York 5, N. Y.
Of Counsel.

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Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in the above entitled case on March 9, 1954.

Opinions Below

The opinion of the Tax Court (R. 3) is reported at 19 T. C. 581. The opinion of the Court of Appeals is reported at 211 F. 2d 522.

Jurisdiction

The judgment of the Court of Appeals was entered on March 9, 1954. The jurisdiction of this Court is invoked under 28 U. S. C. § 1254 (1) and Section 1141 (a) of the Internal Revenue Code.

Question Presented

The sole question presented is whether $170,038.04 received by the petitioner in 1948 from a director and a stockholder in satisfaction of "insider" liabilities for "short-swing profits", imposed by Section 30(f) of the Investment Company Act of 1940 and Section 16(b) of the Securities Exchange Act of 1934, was includible in petitioner's "gross income".

Statutes and Regulations Involved

Section 22(a) of the Internal Revenue Code:

> "(a) GENERAL DEFINITION.—'Gross income' includes gains, profits, and income derived, from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever . . ."

U. S. Treas. Reg. 111, Sec. 29.22(a)-1:

> "*What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22(b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include

profit gained through sale or conversion of capital assets. Profits of citizens, residents, or domestic corporations derived from sales in foreign commerce must be included in their gross income; but special provisions are made for nonresident aliens and foreign corporations by sections 211 to 237 inclusive, and, in certain cases, by section 251, for citizens and domestic corporations deriving income from sources within possessions of the United States. Income may be in the form of cash or property."

Section 30(f) of the Investment Company Act of 1940, 15 U. S. C. § 80a-29(f):

"(f) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of outstanding securities (other than short-term paper) of which a registered closed-end company is the issuer or who is an officer, director, member of an advisory board, investment adviser, or affiliated person of an investment adviser of such a company shall in respect of his transactions in any securities of such company (other than short-term paper) be subject to the same duties and liabilities as those imposed by section 16 of the Securities Exchange Act of 1934 upon certain beneficial owners, directors, and officers in respect of their transactions in certain equity securities."

Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78p(b):

"(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in

entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Statement

The pertinent facts, as they were found by the Tax Court (R. 3-6), are as follows:

Petitioner, a Delaware corporation with its principal office in New York City, is a registered closed-end investment company as defined in the Investment Company Act of 1940. Petitioner filed a Federal income tax return for 1948, prepared on an accrual basis, with the Collector of Internal Revenue for the Second District of New York.

On or about April 1, 1944, one of the petitioner's directors acquired warrants to purchase shares of petitioner's common stock. On or about the same date, a stockholder of petitioner, who at all times between June 5, 1945 and June 17, 1946 owned more than 10% of the then outstanding warrants, also acquired warrants to purchase shares of petitioner's common stock.

Between June 5, 1945 and June 17, 1946, the director, individually and through a partnership of which he was a

member, and the stockholder, individually and through a partnership of which he was a member, sold on the New York Stock Exchange certain shares of petitioner's common stock.

On December 4 and 18, 1945, the director and the stockholder exercised certain of their warrants and purchased shares of petitioner's common stock. These purchases upon the exercise of warrants were the only purchases of common stock of petitioner by the director and the stockholder from June 5, 1945 to June 17, 1946.

Pursuant to Section 30(f) of the Investment Company Act of 1940 and Section 16(b) of the Securities Exchange Act of 1934, the director and the stockholder were required to pay to petitioner certain "profits", as that term is used in the Securities Exchange Act of 1934, realized upon the sales and purchases, or purchases and sales, of shares of petitioner's common stock between June 5, 1945 and June 7, 1946, inclusive. The "profits" were paid by the director and the stockholder to petitioner upon the advice of counsel and without litigation. The "profits" were computed by subtracting from the highest amounts realized by the director and the stockholder on their sales of the stock the average amounts the director and the stockholder had paid to petitioner on the exercise of the warrants plus the average cost of the warrants themselves.

The "profit" required to be paid petitioner by the stockholder as a result of such transactions was computed to be $129,362.95, and the "profit" required to be paid petitioner by the director as a result of such transactions was computed to be $81,092.33. The director paid petitioner $40,417.24 on March 9, 1946, and he paid his remaining $40,675.09 and the stockholder paid his entire $129,362.95, which together total $170,038.04, to petitioner in 1948.

The Tax Court held, with one judge dissenting, that the $170,038.04 received by petitioner in 1948 from the director

and the stockholder was gross income to petitioner, against which petitioner was entitled to deduct an expense of $13,000 incurred as legal fees in recovering that amount.

The decision of the Tax Court was affirmed by the Court of Appeals for the Second Circuit.

Reasons for Granting the Writ and Argument

I

The decision below is in conflict with the recent decision of the Court of Appeals for the Third Circuit in *Commissioner* v. *Glenshaw Glass Co.* (April 9, 1954).*

It is respectfully submitted that the decision below is basically in conflict with the above mentioned decision in *Glenshaw Glass Co.* To be sure, both Courts indicated that the cases might be distinguishable. But each Court attempted to distinguish or indicated the possibility of distinguishing the case in the other Court on grounds which the other Court either expressly rejected or failed to recognize. A third Court, the Court of Claims in *Park & Tilford Distillers Corp.* v. *United States*, 107 F. Supp. 941 (1952), cert. denied 345 U. S. 917 (1953), treated the two situations as indistinguishable.

The decisions are in fact so closely related that their coexistence, without reversal of one or the other, or without an authoritative explanation of the reasons for differing results, can only lead to confusion and invite future controversy.

A. *The decision below.* The Court below was confronted with these facts: Petitioner received sums of money from a director and a 10% stockholder, acting under compulsion of Section 16(b) of the Securities Exchange Act of 1934 as made applicable by Section 30(f) of the Investment Company Act of 1950. It did not obtain these

* The opinion in *Commissioner* v. *Glenshaw Glass Co.* has not yet been reported in the Federal Reporter System. It is reported at 5 CCH Fed. Tax Rep. ¶ 9328 (1954) and is printed as an appendix to this petition.

receipts in pursuit of any gain. It did not expect them. It had no control over the circumstances which led to the receipts. It gave nothing whatsoever in return. No effort or activity on its part generated the receipts. It was in legal effect forced to accept the payments irrespective of its own wishes. The receipts had no relation to petitioner's property or its business activity or to any act or promise or undertaking or forbearance on its part. The receipts were not in substitution for or in replacement of any lost corporate profits. There was no periodicity about them.

Petitioner received the money because Congress, interested as a matter of public policy in deterring possible injury to stockholders through misuse by insiders of inside information, decided to penalize the insider who purchases and sells securities of his corporation within six months by depriving him of any "profit" he might realize therefrom, wholly without reference to whether any inside information was used and even without reference to whether the so-called "profit" is really attributable, in a case such as this, to appreciation in value of stock purchase warrants held for a period considerably longer than six months. Congress could have required the so-called "profit" to be forfeited to the Federal Government or it could have required the forfeited amounts to be distributed among the stockholders for whose protection the provision was enacted. It chose, however, the more convenient course of requiring the forfeited amounts to be paid to the corporation, thus indirectly benefiting all stockholders, and gave the stockholders a right to enforce collection if the corporation failed to do so. In a real sense and in economic effect, from the standpoint of the corporate recipient they resemble legally enforced capital contributions for the benefit of the stockholders. From the standpoint of the insider, the amounts in question were penalties (*Smolowe* v. *Delendo Corp.*, 136 F. 2d 231 (2d Cir. 1943), cert. denied 320 U. S. 751 (1943)), which the insider could not deduct from gross income for

Federal income tax purposes. *William F. Davis, Jr.*, 17 T. C. 549 (1951). In any event, the circumstances giving rise to the obligation to pay and receive were entirely beyond petitioner's control, were not compensation for any injury inflicted on it and had nothing whatsoever to do with its property or its labor or any action or inaction of any kind on its part.

The Court below, affirming the Tax Court, held that the sums received by petitioner constituted income within the meaning of Section 22(a) of the Internal Revenue Code. The Court's reasoning was in substance that there is no common principle or touchstone by the application of which one may infallibly determine what is and what is not income in a given case; that an empirical case-by-case approach must be adopted; that no considerations of policy affect the case one way or the other since the purpose of Section 16(b) will be served equally well whether or no the payments are held to be income to the recipient corporation; that, taking the statutory words "gains or profits and income from any source" in their plain, popular meaning, the Section 16(b) payments constituted income—the petitioner having unrestricted discretion to use the funds for any purpose whatsoever and they being in no sense donations or contributions to capital, payments by way of restoration of lost capital or compensation for any loss suffered by petitioner.

With regard to the cases holding punitive and treble damage recoveries not income, the Court said policy considerations may in the end there play a decisive or persuasive role; but the Court refused to express any opinion thereon, pointing out that such policy considerations may perhaps have no relevance and the Court of Claims may be right in the *Park & Tilford Distillers Corp.* case in saying those cases were wrongly decided.

B. *The decision in Commissioner v. Glenshaw Glass Co.* Here the Court was confronted with these facts:

espondent Glenshaw Glass Co. received money in settle-ent of a suit in which it claimed punitive damages ased upon a competitor's fraudulent suits disastrously ffecting its business, as well as treble damages under Sec-on 4 of the Clayton Act. Respondent William Goldman heatres, Inc. received money in satisfaction of a judgment r treble damages awarded to it pursuant to Section 4 the Clayton Act.

The Court of Appeals for the Third Circuit, affirming ecisions in the Tax Court, held that the punitive and eble damages received over and above actual damages ere not taxable income under Section 22(a) of the In-rnal Revenue Code. In so holding, the Court rejected e government's argument that all money or property oming into a person's hands is taxable as income unless ecifically exempted by statute, saying it had found no se in which the Court did not look to source as at least loring or bearing upon the incidence of taxation. Pay-g considerable allegiance to this Court's definition of in-me in *Eisner* v. *Macomber*, 252 U. S. 189 (1920), and to e requirement that "income" be interpreted as used in mmon speech, the Court said that the payments to the tax-yers in the cases before it could not fairly be regarded products of capital or labor and that in the Court's view e ordinary man regards income as something which mes to him from what he has done, not from something hich is done to him, and would not regard punitive dam-ges, a mere windfall, as income. Recognizing that the sition of the government would bring symmetry into this pect of the law, the Court concluded that if such a result to be achieved it would be effected by this Court.

C. *Similarity in principle between this case and Glen-aw Glass Co.* Petitioner submits there is no logical dis-nction between the treatment of a Section 16(b) recovery nd a punitive or treble damage recovery. The activities ving rise to recovery under Section 16(b) are no less

contrary to public policy than the activities giving rise to the recovery in a punitive or treble damage case.

Though the Court in the *Glenshaw Glass Co.* case said punitive damages seem to be *sui generis,* the Court's reasons for holding them not to be taxable income are strikingly applicable to a Section 16(b) payment also. The Court made the following points in favor of nontaxability of punitive damages.

"By definition they are not compensatory." It can equally be said that a Section 16(b) payment is not compensatory.

"They certainly possess no periodicity." This is true also of a Section 16(b) payment.

"They are not derived from capital, from labor or from both combined and assuredly they are not profit gained through the sale or conversion of capital assets." This too is equally true of a Section 16(b) payment.

Punitive damages "smack of donations made to the individual by the State, by operation of law. A person does a prohibited act to another injuring him. The injured individual is subsequently enriched by a gift taken from the pocket of the injuring party by virtue of law. There is no *quid pro quo.* An analogy seems to us to lie in those cases where contributions are made by the sovereign in the general public interest to an individual. . . . The taxpayers have recovered because the sovereign has seen fit to punish gross behavior for the good of the public. There are naked exactions by the sovereign which go to the injured corporations rather than to the fisc. There is vague likeness to a fine exacted by the sovereign but which goes to the taxpayer." This again is strikingly applicable to a Section 16(b) payment, except of course that the recipient may not have been injured. But the payments in both cases are dictated by the sovereign and are above and beyond any injury.

D. *Invalidity of attempted distinction based on statutory language.* The Court in the *Glenshaw Glass Co.* case presumably recognized the foregoing similarities for it distinguished the Section 16(b) cases on the ground that the making of a profit by the insider is the mainspring of Section 16(b) and that under the operation of the statute, which requires profit to be passed on to the corporation, all the stockholders receive via the corporate entity the profit made by the prohibited transaction. The Court placed particular emphasis upon the concurring opinion in the Tax Court in the present case (R. 11-12) which reasoned in effect that a Section 16(b) payment is income to the corporate recipient since Section 16(b) provides that any "profit realized" by the insider "shall inure to" the issuer. No other reason was given in the *Glenshaw Glass Co.* case for saying that the Section 16(b) cases are distinguishable. Yet the Court below in the present case expressly held that such reasoning will not bear analysis.

In this, the Court below was clearly correct. If a Section 16(b) payment is income to the recipient corporation as a "profit realized" by the insider that "inures to" the corporation, the nature of the income in the hands of the corporation should be the same as in the hands of the offending insider who realized it. If it was a long-term capital gain to him, it should be the same to the corporation.

But this approach encounters difficulties when it is considered that the amount of "profit realized" by the insider for the purpose of Section 16(b) has no necessary relation to the amount of profit realized by the insider for income tax purposes. The former is arrived at by calculating the maximum profit that could have been realized without regard to the profit or loss on the particular stock sold and is not limited to the profit, if any, actually realized as determined under the income tax law. The amount of a Section 16(b) payment is measured under the statute by the excess of the highest sales prices of shares sold during a six

months' period over the lowest purchase prices of shares purchased during such period, without regard to the identity of the shares or certificates purchased or sold. See *Smolowe* v. *Delendo Corp., supra.* In other words, it is a theoretically computed figure having no relation to any actual taxable gain or loss of the insider. The insider may have suffered a capital loss for tax purposes and by virtue of the same sale have a profit payable to the corporation under Section 16(b). It therefore seems wholly fallacious, in determining the status to the recipient of a Section 16(b) payment, to be influenced by the fact that a so-called "profit realized" by the insider is referred to and is made to "inure to and be recoverable by the issuer".

Section 16(b) in referring to "any profit realized" speaks of profit realized by the insider; it is the insider's profit which the statute says "shall inure to and be recoverable by" the issuer. Simply because an item represents profit to one person, it does not follow that it also represents a profit to another to whom the law requires the first person to pay it over. The provision that the insider's profit shall inure to the corporation is simply a device to insure that he shall not benefit from it. While profits technically received by one person may be imputed to another in appropriate circumstances under the doctrine of such cases as *Lucas* v. *Earl*, 281 U. S. 111 (1930), *Helvering* v. *Clifford*, 309 U. S. 331 (1940), and *Helvering* v. *Horst*, 311 U. S. 112 (1940), the profit in such cases is not taxed to both parties but is taxable only to the person to whom the income is imputed because that person is deemed to have earned it or to be the owner of the property producing it. This doctrine has no possible application here. Respondent insists that the insider is taxable on any gain realized in connection with his security transactions, even though the transactions gave rise to liability under Section 16(b). *I. T. 4069*, 1952-1 C. B. 28. Yet, the insider cannot deduct the Section 16(b) payment for income tax purposes since it is a penalty. *William F. Davis, supra.* It is funda-

mentally inconsistent to tax the so-called "profit" to the insider and at the same to tax it to the petitioner because the statute says it shall "inure" to petitioner.

II

The decision below is in conflict with this Court's conception of the characteristic and distinguishing attributes of income for Federal income tax purposes, as expressed more than thirty-three years ago in *Eisner* v. *Macomber*, 252 U. S. 189 (1920), and as repeatedly applied by this Court in subsequent decisions.

Section 22(a) of the Internal Revenue Code does not purport to include in gross income all receipts or accessions to wealth. It limits the inclusion to income and, although it illustrates the type of thing Congress had in mind, it makes no attempt to define it. Congress left to the courts the interpretation of that term and its application to the myriad of unforeseeable factual situations that might arise. Indeed, for this latter reason, Congress, however alert to avoid possible undue expansion of the grasp of the income tax, could hardly as a practical matter have done otherwise.

What then is income? Economists have differing conceptions, such as the "service-flow" in consumption theory, the "recurrent receipts" theory and "the net addition to economic power" or the so-called "net accretion" theory. For the practical purposes of income taxation, is the meaning of the term "income" to be controlled by any of these economic abstractions? Or is it to be arrived at on a practical, rational basis in keeping with popular concepts of income?

More than thirty-three years ago, in *Eisner* v. *Macomber*, 252 U. S. 189 (1920), this Court faced this problem and laid down a definition expressing its view as to the

underlying concepts. Under this definition, a receipt to constitute income must have been derived from capital or labor or from their combination. Specifically, the Court said: "'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets . . ." These terms, expressing basic principles, are of course to be interpreted broadly. But where it cannot be said that a receipt is the product of the capital of the recipient (or in substitution for such product), or the product of his labor (*i.e.*, the return for some action, effort, service or forbearance on his part), or, in some cases under a specific statutory income tax pattern, the product of the capital or labor of one to whom the recipient bears a special relationship (such as donor and donee or divorced husband and wife), it is not income, even though an accession to wealth results.

So far as we are aware, this Court has never questioned the soundness of this basic concept of the characteristic and distinguishing attributes of income for tax purposes. On the contrary, in other cases since 1920 and indeed as recently as 1952 this Court has repeatedly applied and adhered to the *Eisner* v. *Macomber* concept of income. See *Helvering* v. *Griffiths*, 318 U. S. 371 (1943), in which this Court refused to overrule *Eisner* v. *Macomber; Merchants' Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509 (1921); *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170 (1926); *Taft* v. *Bowers*, 278 U. S. 470 (1929); *United States* v. *Safety Car Heating Co.*, 297 U. S. 88 (1936); *Commissioner* v. *Culbertson*, 337 U. S. 733 (1949); and *Rutkin* v. *United States*, 343 U. S. 130 (1952). To be sure, in *United States* v. *Kirby Lumber Co.*, 284 U. S. 1 (1931), Mr. Justice HOLMES, speaking for this Court, said in his characteristic way, in referring to the *Eisner* v. *Macomber* definition: "We see nothing to be gained by the discussion of judicial definitions." But the income held to have been

realized in the *Kirby* case resulted from the taxpayer's financial transactions and activities, including the use of its capital, and it could easily have been held to come within the broad meaning of the source language of the *Eisner* v. *Macomber* definition. Indeed, the only court decisions which cannot be justified under the *Eisner* v. *Macomber* income definition are the recent decisions in the Section 16(b) cases.

This Court has never accepted the Commissioner's argument below and in the *Glenshaw Glass* case that all accessions to wealth constitute taxable income unless specifically excepted by statute. Since *Eisner* v. *Macomber*, this Court has specifically held that certain accessions to wealth, not specifically excluded from gross income by Section 22(b) of the Code, do not constitute gross income. *Brown Shoe Co.* v. *Commissioner*, 339 U. S. 583 (1950) (contribution by community group to taxpayer to induce location of plant in community not income); and *Edwards* v. *Cuba R.R. Co.*, 268 U. S. 628 (1925) (subsidy received by taxpayer from Cuban Government to induce railway construction not income).

Since 1922, the Treasury Regulations have combined the definition of gross income included in Section 22(a) of the Code with the above quoted definition of income from *Eisner* v. *Macomber*. (U. S. Treas. Reg. 62, Art. 31, issued under the Revenue Act of 1921; and U. S. Treas. Reg. 111, Sec. 29.22(a)-1 (1943).) During all this period the Treasury Regulations have not been changed in this respect.

There is no evidence so far as we know that Congress is dissatisfied with the *Eisner* v. *Macomber* concept of income. Indeed, the latest evidence indicates the contrary.*

* In the proposed new Revenue Code of 1954, H. R. 8300, 83rd Congress, 2nd Session, it is proposed in Subchapter B, Part II, Section 74, to exclude from gross income amounts received as prizes and awards made primarily in recognition of religious, charitable, educational, artistic, literary or civic achievement if "the recipient was selected without any action on his part" and "is not required to render substantial future services as a condition to receiving the prize or award".

The *Eisner* v. *Macomber* concept has been generally accepted. The Committee on Terminology of the American Institute of Accountants, in commenting upon it, has stated that it conforms closely to the accounting concept and is appropriate for adoption by accountants for general application. See Accounting Research Bulletin No. 9, American Institute of Accountants, May 1941, page 72; Thomas W. Leland, Contemporary Accounting, 1945, Chapter 3, page 1.

With such a consistent, long-standing recognition of the basic characteristics of income for the practical purposes of taxation through repeated reenactments and amendments of the statute, it is submitted that if any change in those characteristics is to be made at this late date it should be done by Congress and not by the courts.

This is not to suggest that this Court should be hidebound by a literal interpretation of its own earlier definition. This Court has of course, since then, developed and refined the law with respect to some aspects of income with which we are not here concerned, namely, with respect to questions of sufficiency of severance, time of realization, claim of right and imputed income. See *e.g.*, *Helvering* v. *Bruun*, 309 U. S. 461 (1940), and *Rutkin* v. *United States*, *supra*. But so far as we are aware, with the exception of the recent Section 16(b) cases, there is no decision of this Court or of any other Court since *Eisner* v. *Macomber* in which a receipt has been held to be income which would not be income under a reasonable interpretation of the source rule, the "capital" and "labor" language, of the *Eisner* v. *Macomber* definition. And we submit that the importance of stability in the highly practical law of taxation should dictate that in so far as the required sources of derivation are concerned no change should be made at this late date in the established meaning of income for tax purposes, at least without some indication of a Congressional desire for a change.

III

The decision below involves an important principle of tax law which ought to be clarified and settled by this Court in the interest of sound and proper application of the internal revenue laws.

There are already indications that the recent decisions in the Section 16(b) cases are inviting administrative attempts to expand the grasp of the income tax so as to apply to receipts never before considered to constitute income.

If the receipts here in question constitute income to the petitioner even though not derived from the petitioner's capital or labor or both, or any action or inaction on its part, it is difficult to see why the accidental finding of treasure-trove would not *a fortiori* constitute income. A finder at least does something and his find is the result of his own free and uncontrolled action. Never until recently in the long history of Federal income taxation has any attempt been made so far as we know to tax the accidental finding of treasure-trove as income. But following his success in the Court of Claims and the Tax Court in the Section 16(b) cases, the Commissioner has recently ruled, contrary to common belief, that the finding of treasure-trove is the receipt of taxable income (no indication being given as to the effect of the finder's rejection of his find). See *Revenue Ruling 61*, 1953—1 C. B. 17.

Where is the dividing line to be drawn between what is and what is not income if it is not drawn essentially along the lines this Court has heretofore indicated? Surely it is not to be drawn haphazardly on a case-by-case basis, as suggested by the Court below, without any guiding rules whatever other than the particular court's hunch as to popular understanding or its notion concerning public policy considerations. The Court below thought it of no

help to talk about "windfalls" or "penalty". But the Court in the *Glenshaw Glass Co.* case said: "We do believe that a 'windfall' . . . would not be regarded as 'income' within the terms of common speech. . . . We believe that the ordinary man regards income as something which comes to him from what he has done, not from something which is done to him." The Court said, further: "A single gift of money or property probably should not be treated as taxable income even if the specific exemption granted to gifts by statute were unavailable." Unless this Court clarifies the important basic principle involved in this case and the *Glenshaw Glass Co.* case, confusion and interminable litigation are likely to ensue.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

NORRIS DARRELL,
JOHN F. DOOLING, JR.,
Counsel for Petitioner,
48 Wall Street,
New York 5, N. Y.

SULLIVAN & CROMWELL,
48 Wall Street,
New York 5, N. Y.
Of Counsel.

June, 1954.

APPENDIX

Commissioner of Internal Revenue, Petitioner v. *Glenshaw Glass Company, Respondent. Commissioner of Internal Revenue, Petitioner* v. *William Goldman Theatres, Inc., Respondent.*

In the United States Court of Appeals for the Third Circuit. Nos. 11,073, 11,150. April 9, 1954.

Appeals from the Tax Court of the United States.

Before BIGGS, Chief Judge, and MARIS, MCLAUGHLIN, KALODNER, STALEY and HASTIE, Circuit Judges.

OPINION OF THE COURT

BIGGS, Chief Judge: The Commissioner seeks to reverse two decisions of the United States Tax Court in favor of two taxpayers. In Glenshaw a claim for punitive damages based upon a competitor's, Hartford's, fraudulent suits which disastrously affected the taxpayer's business, as well as a claim for treble damages under Section 4 of the Clayton Act, 15 U. S. C. A. § 15, were settled by the payment of a sum of money.[1] In Goldman a judgment for treble damages was awarded Goldman against Loew's, Inc.,[2] also pursuant to Section 4 of the Clayton Act. The sole question presented for our determination is whether moneys paid as punitive or statutory treble damages are taxable as income under Section 22(a) of the Internal Revenue

[1] For the history of the litigation see: *Hartford-Empire Co.* v. *Shawkee Mfg. Co.*, 163 Fed. (2d) 474 (3 Cir. 1947); *Hartford-Empire Co.* v. *Shawkee Mfg. Co.*, 67 Fed. Supp. 26 (D. C. W. D. Pa. 1946); *Hartford-Empire Co.* v. *United States*, 323 U. S. 386 (1945); *Hartford-Empire Co.* v. *Shawkee Mfg. Co.*, 147 Fed. (2d) 532 (3 Cir. 1944); *Shawkee Mfg. Co.* v. *Hartford-Empire Co.*, 322 U. S. 271 (1944), reversing *Hartford-Empire Co.* v. *Shawkee Mfg. Co.*, 137 Fed. (2d) 764 (3 Cir. 1943); *Shawkee Mfg. Co.* v. *Hartford-Empire Co.*, 68 Fed. (2d) 726 (3 Cir. 1934); and *Hartford-Empire Co.* v. *Hazel-Atlas Glass Co.*, 59 Fed. (2d) 399 (3 Cir. 1932).

[2] See *William Goldman Theatres, Inc.* v. *Loew's, Inc.*, 164 Fed. (2d) 1021 (3 Cir. 1948).

Code.[3] The Tax Court has decided that they are not and the Commissioner of Internal Revenue has petitioned this court for review.[4] Insofar as the issue before us is concerned no valid distinctions can be drawn between a money settlement and money paid in satisfaction of a judgment or between punitive damages levied for fraud and treble damages rendered under the Clayton Act.[5]

The positions of the taxpayers are based in large part upon the definition of "income" set out in *Eisner* v. *Macomber*, 252 U. S. 189, 207 (1920), on the decision of this court in *Central R. Co.* v. *Commissioner*, 79 Fed. (2d) 697 (1935), the decision of the Board of Tax Appeals in *Highland Farms Corporation*, 42 B. T. A. 1314 (1940), and the applicable Treasury Regulations.[6,7] The taxpayers also

[3] Section 22(a) of the Internal Revenue Code, in pertinent part, is as follows:

"*General Definition.*—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever . . ."

[4] The Tax Court opinions are reported at 18 T. C. 860 (*Glenshaw*) and 19 T. C. 637 (*Goldman*). See also *Obear Nester Glass Co.*, 20 T. C. No. 152, and *Telefilm, Inc.*, 21 T. C. —, similar cases.

[5] The Commissioner and Glenshaw do not now dispute that $324,529.94 was the amount paid in settlement of punitive damages. In the *Goldman* case the amount of actual damage, found to be $125,000, was trebled and a judgment was entered for $375,000. We are concerned solely with the taxability of the sum of $324,529.94 (*Glenshaw*) and the taxability of $250,000 (*Goldman*).

[6] The facts of the *Central R. Co.* case are distinguishable from those at bar. In the *Central R. Co.* case the taxpayer received property in settlement of a suit brought by it against an unfaithful officer who violated his fiduciary duty to it and thereby deprived the railroad of revenues. A kind of resulting or constructive trust was imposed upon the fruits of his fraud in favor of the railroad company. Nevertheless this court considered the railroad's gain to be a "windfall", not derived either wholly or in part from the taxpayer's capital or labor and therefore not income at all within the definition of *Eisner* v. *Macomber*.

The decision was followed by the Board of Tax Appeals in *Highland Farms Corporation, supra*, where punitive damages were allowed for slander of title to land. The Board of Tax Appeals refused to treat these punitive damages as income, relying also on the test of taxable income set out in *Eisner* v. *Macomber*.

[7] Treasury Regulations 111, in pertinent part provide:

"Sec. 29.22(a)-1. *What Included in Gross Income.*—Gross income includes in general compensation for personal and professional services, business income,

assert considerations which are based on the general philosophy of income taxation but we will not discuss these specifically in this opinion. But the United States for its part contends that *Eisner* v. *Macomber* does not settle the applicable definition of what constitutes taxable income insofar as the cases at bar are concerned, that the decision of this court in the *Central R. Co.* case is not applicable, but if it is, it was wrongly decided, and that the decision of the Board of Tax Appeals in *Highland Farms* was clearly erroneous. The substance of the government's argument is that all property or money coming into the hands of a taxpayer is income except where specifically exempted by the taxing statute.

In *Eisner* v. *Macomber* the Supreme Court stated: "'Income may be defined as a gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through sale or conversion of capital assets . . ." In *Eisner* v. *Macomber* the Supreme Court laid emphasis on the ordinary meaning of income in common parlance and said, 252 U. S. at pp. 206-207: "For the present purpose we require only a clear definition of the term 'income' as used in common speech, in order to determine its meaning in the Amendment . . ." The second sentence of the applicable Treasury Regulations adopted the *Eisner* v. *Macomber* definition *in toto*. See note 7 of this opinion. The only qualification of the second sentence of the regulation lies in the phrase "in general" and surely little can be taken from that. Of course, as the United States points out, in *Eisner* v. *Macomber* the Supreme Court was primarily concerned with distinguishing between capital and income, not between sources of property which came into the hands of the taxpayer and we cannot doubt but that the Supreme Court has departed in

profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (see section 22(b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. . . ."

some degree from the *Eisner* v. *Macomber* definition. This is apparent from *United States* v. *Kirby Lumber Co.*,[8] 284 U. S. 1, 3 (1931) where Mr. Justice Holmes stated: "We see nothing to be gained by the discussion of judicial definitions."

If the property or money paid represents a return of capital or a contribution to capital it is not subject to income taxation. Subsidies paid by a sovereign to aid in the construction and operation of a railroad line were held not to be income in *Edwards* v. *Cuba R. R. Co.*, 268 U. S. 628 (1925) and the money and property acquired were treated in effect as an accretion to capital. But compare *Detroit Edison Company* v. *Commissioner*, 319 U. S. 98 (1943) where the Supreme Court has indicated some halt in the doctrine of capital donation expressed in *Edwards* v. *Cuba R. R. Co.*, *supra*. Cf. also *Great Northern Ry. Co.* v. *Commissioner*, 8 B. T. A. 225 (1927), aff'd 40 Fed. (2d) 372 (8 Cir., 1930). A single gift of money or property probably should not be treated as taxable income even if the specific exemption granted to gifts by statute were unavailable. Periodicity seems to be considered a factor. See *Irwin* v. *Gavit*, 268 U. S. 161, 168 (1925); Magill, *Taxable Income*, *supra*, note 8, at p. 428. The spontaneity of the gift may also serve to relieve the recipient of tax. See *Bogardus* v. *Commissioner*, 302 U. S. 34, 42 (1937), *Washburn* v. *Commissioner*, 5 T. C. 1333 (1945).[9]

The United States lays emphasis on the decision of the Court of Claims in *Park & Tilford Distillers Corp.* v. *United States*, 107 Fed. Supp. 941, 943-5 (1952). In this case the issue was whether a recovery under Section 16(b)

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[8] The lumber company purchased its own bonds in the open market at less than par and the difference in price was held to be taxable as income. It is clear, however, that compensatory damages for loss of income are taxable as income and that income takes its color from source. See Chapter 10 "Compensatory Payments," *Taxable Income*, Magill, Rev. Ed., 1945, at p. 377 *et seq.*

[9] Sums of money won by way of contest awards are taxable. See *Robertson* v. *United States*, 343 U. S. 711 (1952). But these cases are readily distinguishable from a mere gift since services are rendered. Lottery prizes are also distinguishable. See *Huntington* v. *Commissioner*, 35 B. T. A. 835 (1937).

of the Securities Exchange Act, 15 U. S. C. A. § 78p(b), constituted income to the recovering corporate taxpayer. The Court of Claims held that the recovery was taxable as income and specifically rejected the reasoning of this court in *Central R. Co.* v. *Commissioner* and the decision of the Board of Tax Appeals in *Highland Farms*. The Court of Claims stated: "The money came in from an outside source, it went into the plaintiff's treasury, it did not replace something which went out of plaintiff's ownership as a consideration for it." The Court went on to say that it was unwilling to surmise that the definition of "income" of *Eisner* v. *Macomber* was sufficient to read out of the taxing statute the phrase "income derived from any source whatever". In our opinion the theory of recovery under Section 16(b) of the Securities Exchange Act of 1934 is not a purely punitive one. The statute was designed to prohibit profit being made by an "insider" possessing peculiar knowledge of future profitable operations of his corporation. The making of a profit by the "insider" is the mainspring of the statute, a profit required by law to be passed on to the corporation probably because the corporation is the most convenient receptacle. An "outsider" purchasing stock in the open market, theoretically at least, would be compelled to pay a higher price because an insider was purchasing stock in the market against him. But, under the operation of the statute, all of the stockholders, save only the "insider" whose operations were prohibited by statute, would receive via the corporate entity the profit made by the prohibited transaction.[10] We do

[10] The nature of Section 16(b) of the Securities Exchange Act of 1934 is referred to in 66 Harv. L. Rev. at p. 408 as follows:

"We are unaware of any other statute that offers a precise analogy to this subsection. It has within it elements of an ordinary shareholder's derivative suit for damages based upon a breach of fiduciary duty, elements of a statutory action for punitive damages, and elements of an informer's statute. It appears to proceed on the principle that the confidential information which a corporate insider automatically obtains by virtue of his position belongs to the corporation. Having availed himself personally of this information, the insider is made liable to the corporation for the profits he realizes. Unlike the 'corporate opportunity' cases, however, the action may be brought even though the insider has not competed with his corporation in the use of the information. The courts have found each of these analogies useful, but none furnishes compelling authority."

not agree with the position of the Court of Claims that Park & Tilford's recovery was purely a "windfall".

In *General American Investors Company, Inc.* v. *Commissioner*, 19 T. C. 581 (1952), affirmed,—Fed. (2d)—(2d Cir., 1954), the Tax Court followed the *Park & Tilford* decision of the Court of Claims but distinguished its decision from that in the instant *Glenshaw Glass Company* case and the decisions in *Central R. Co.* and *Highland Farms* employing the definition of taxable income of *Eisner* v. *Macomber*. Judge Murdock in his concurring opinion pointed to the provisions of Section 16(b) of the Securities Exchange Act of 1934, viz., that "any profit realized" under the circumstances presented by the *General American Investors* case "shall inure to and be recoverable by the issuer", i. e., the corporation. Judge Murdock took the position that the profits were income to General American Investors within the purview of Section 22(a) of the Internal Revenue Code "since they were 'profits' either from 'sales or dealings in property . . . growing out of the ownership of . . . or interest in such property' or 'from any source whatsoever'."

The facts of the *Park & Tilford* and the *General American Investors* decisions are distinguishable from those at bar and from *Central R. Co.* v. *Commissioner*, *supra*.

The United States contends that the "source of gain" should not be controlling in view of the final phrase of Section 22(a) dealing with gains or profits or income "derived from any source whatever"; that the phrase last quoted expresses congressional intent that the source of income or gain is immaterial—a complete negation of the concept of source in relation to taxable income. The government in substance asserts that any money or property coming into the hands of any person is taxable as income unless specifically exempted. But we have found no case in which the court did not look to source as at least coloring or bearing upon the incidence of taxation.

Punitive damages seem to be *sui generis*. By definition they are not compensatory. They certainly possess no periodicity. They are not derived from capital, from labor or from both combined and assuredly they are not profit gained through the sale or conversion of capital assets. It is clear that they do not fall within the definition of *Eisner* v. *Macomber* and if we could be certain that the definition of that case was controlling we would have no difficulty with the issue at bar. It is easy to say what punitive damages are not but difficult to say what they really are. They smack of donations made to the individual by the State, by operation of law. A person does a prohibited act to another injuring him. The injured individual is subsequently enriched by a gift taken from the pocket of the injuring party by virtue of law. There is no *quid pro quo*. An analogy seems to us to lie in those cases where contributions are made by the sovereign in the general public interest to an individual. Cf. *Edwards* v. *Cuba Railroad Company*, *supra*. Where the injuries were gross, the doctrine of punitive damages comes into play. The taxpayers have recovered because the sovereign has seen fit to punish gross behavior for the good of the public. There are naked exactions by the sovereign which go to the injured corporations rather than to the fisc. There is vague likeness to a fine exacted by the sovereign but which goes to the taxpayer.

The Supreme Court has never expressly departed from the definition of income of *Eisner* v. *Macomber*. In fact it has reiterated it fairly recently. See *Merchants Loan and Trust Company* v. *Smietanka*, 255 U. S. 509, 519 (1921) and *Commissioner* v. *Culbertson*, 337 U. S. 733, 740 (1949). And see *Helvering* v. *Griffiths*, 318 U. S. 371 (1943) in which the Supreme Court expressly declined to overrule *Eisner* v. *Macomber* on the facts there presented. The *Culbertson* decision cites not only Treasury Regulation 101, Article 22(a)-1 but also 1 Mertens, Law of Federal Income Taxation, 159 *et seq.* See the authorities set out in note 9 cited to § 5.02 of Mertens. We concede that no definition

is too helpful, *United States* v. *Kirby Lumber Co., supra,* and that the decisions relating to income tax law contain charts rather than definitions, as Mr. Mertens has aptly stated. But it should be borne in mind that in *Eisner* v. *Macomber,* albeit where severability was the primary issue, the Supreme Court said, 252 U. S. at pp. 206-207, that "only a clear definition of the term 'income' as used in common speech . . ." was required. We do believe that a "windfall"—and the payments at bar were "windfalls"—would not be regarded as "income" within the terms of common speech. Certainly the payments to the taxpayers cannot fairly be regarded as products of capital or labor. We believe that the ordinary man regards income as something which comes to him from what he has done, not from something which is done to him. This is perhaps an over-simplification but we are of the opinion that the ordinary man using terms of common speech would not regard punitive damages as "income."

We must further concede that the decision of this court in *Central R. Co.* v. *Commissioner* cannot be deemed to be overwhelmingly persuasive for the sources of the moneys in that case can be distinguished from the sources of the moneys sought to be taxed in the instant cases but the decision has been followed frequently and has been applied to the issue of taxation of punitive damages. See *Highland Farms, supra.* There is as yet no decision which has adopted the contentions made by the Government here. The position of the United States, would indeed, if adopted, bring symmetry into this aspect of the law of income taxation. See "The Taxability of Punitive Damages," 101 U. of P. L. Rev. 1052 (1953). Cf. *Keasbey and Mattison Co.* v. *Rothensies,* 133 Fed. (2d) 894, 897 (3 Cir., 1943). But we think if such a result is to be achieved after nearly two decades it should be effected by the Supreme Court and not by this tribunal.

The decisions of the Tax Court will be affirmed.